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# **Regulation of the Investor Compensation Scheme in the Legal System of the Czech Republic**

## **Abstract of the dissertation**

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This dissertation deals with the Czech legal regulation of the investor compensation schemes. The investor compensation schemes are special compensation mechanisms financed by investment firms (securities broker dealers) whose main purpose is a protection of retail investors, customers of securities brokers dealers, against a default of securities broker dealers (investment firms) resulting in their inability to meet their obligations against their clients and to return to the clients their assets which were entrusted to these firms in connection with investment business. In the case of such failure the compensation schemes will compensate the loss to the clients (in a specified amount and under given conditions). The investor compensation schemes therefore substantially strengthen the confidence of investors in the capital market which is absolutely necessary not only for their smooth operation but also for the smooth operation of the whole economy.

Regarding the importance of investor compensation schemes for preservation of the confidence in financial markets and the European single market of (not only) financial services, the European Parliament and the European Council adopted on 3 March 1997 directive No. 97/9/EC on investor compensation schemes (hereinafter the "ICS directive") imposing the Member States a duty to introduce and officially recognise within their territories at least one investor compensation scheme. Therefore, at least one investor compensation scheme currently operates in each Member State.

The Czech legislator adopted the investor compensation scheme regulation within the harmonisation of the Czech capital market law with *Acquis Communautaire*, including the ICS directive. This harmonisation was carried out by an amendment of Act No. 591/1992 Coll., on Securities, realised through Act No. 362/2000 Coll., amending Act No. 591/1992 Coll., on Securities, as amended, and several other acts. This regulation was severally amended and finally replaced by a regulation contained in head VI of part 9 of Act No. 256/2004 Coll., on Conduct of Business on Capital Market.

The author chose such structure of this dissertation under which he analyses after a brief outline of the not too long history of the Czech investor compensation scheme regulation all important aspects of this law. He deals with a legal nature of entities managing the compensation schemes not only in the Czech Republic but also in another EU Member

States, whose legislators held this regulation often very differently from our law. The Czech Republic investor compensation scheme, from which the compensation is paid to the customers of the investment firm which is unable to meet its obligation vis-à-vis its clients, is managed by a special public law entity – the Guarantee Fund of Securities Broker Dealers (*Garanční fond obchodníků s cennými papíry*). Contrary to that the operators of compensation schemes abroad are represented by e.g. private law companies, trusts, public funds or mechanisms without its own legal personality.

In some Member States (e.g. in Germany) there are several investor compensation schemes operating separately for individual types of investment firms (typically separately for bank and non-bank investment firms). On the contrary, in the Czech Republic, there is only one single investor compensation scheme destined for all investment firms (notwithstanding they are banks or not) and for all management companies providing investment services.

The chapter dedicated to the status of the Guarantee Fund also analyses the issues dealing with the organisational structure of the Guarantee Fund, the status of its statutory body (the board) and the relations vis-à-vis the capital market regulator (the Czech National Bank) and the Ministry of Finance of the Czech Republic.

The following chapter deals with the obligatory participants of the Czech investor compensation scheme, i.e. entities which are required to participate to this scheme and whose clients benefit from the protection provided by this scheme. These participants are all securities broker dealers, all management companies providing investment services and under conditions set by law also foreign entities providing investment services within the Czech Republic territory.

The next chapter analyses issues of funding the investor compensation scheme and the operation costs of the Czech Guarantee fund. The elementary funding models applied in individual EU Member States are analysed there. A separate treatise deals with individual financial sources of the Czech Guarantee fund, mainly with the contributions obligatory paid by the participants of the investor compensation scheme managed by the Guarantee fund (i.e. the base for this contribution calculation, the process of the contribution calculation including several uncertainties of the capital market participants regarding this process).

The following chapter defines the subject of the compensation from the Guarantee fund. The subject of the compensation from the Guarantee fund is client asset which cannot be returned by the investment firm for the reasons directly related to its financial circumstances if the Czech National Bank announced the Guarantee Fund that this investment firm is unable to meet its obligations arising out of investors' claims or a court has made a ruling on insolvency of such investment firm or a ruling suspending investors' ability to claim return of its assets against the investment firm. The author within this chapter in particular analyses the legal definition of the concept of the "client assets", the public law character of this concept and individual elements of this concept. Further, client assets are there defined within the model situations of investment services provision. The author deals with the negative scope of the concept of the "client assets" and critically assesses the relevant judicature.

The next chapter analysis regulation of the compensation payment process, including identification of persons and entities who are not entitled for the compensation, the compensation calculation and the amount of compensation, the statutory limitation period and a period for the compensation payment.

The last three chapters deal with comparison. Firstly the author compares the Czech investor compensation scheme law with a regulation of a similar guarantee scheme provided for by the Act on Banks – the Deposit Insurance Fund (*Fond pojištění vkladů*). The deposit insurance schemes represent related but historically older compensation schemes. It was indeed harmonisation of deposit insurance schemes carried out by directive No. 94/19/EC, on deposit insurance schemes, dated 30 May 1994 which was a model for the investor compensation scheme regulation by the ICS directive. Also the Czech regulation of deposit insurance scheme in the Act on Banks represents a historically older regulation which served as a model for the investor compensation scheme regulation. Both these regulations have a lot of common features however they differ in some important aspects.

The following chapter compare the Czech investor compensation scheme regulation with the investor compensation scheme law in the United Kingdom. The United Kingdom represents a jurisdiction with an

exceptionally developed capital market, a global financial centre (London), which also has a fully functional investor compensation scheme, substantially older than the ICS directive.

The last chapter deals with comparison with the investor compensation scheme law in the Slovak Republic.

The conclusion of this dissertation summarises the main characteristic of the Czech investor compensation scheme law and the shortcomings of this law, including the proposals for their remedy.